No. 12498.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, as Receiver of the Estate of Salsbury Motors, Inc., Debtor,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellee.

APPELLEE'S BRIEF.

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Statement of the Case.

On August 20, 1947, Salsbury Motors, Inc., the debtor in this proceeding, filed a petition for approval of a plan of arrangement under Chapter XI of the Bankruptcy Act (11 U. S. C., Sec. 701, *et seq.*) [R. 2-8]. The debtor remained in possession for a short while and thereafter Geo. T. Goggin, Appellant herein, was appointed Receiver. The Receiver operated the business for a short time, and on July 30, 1948, the Referee signed an order confirming the debtor's second amended plan of arrangement, which provided for the payment by the debtor of a specified sum to be used to pay the expenses of administration and the creditors' claims, the debtor to receive all of its assets free and clear of liens [R. 29-31].

The Appellee Bank of America National Trust and Savings Association, hereinafter called the Bank, filed its claim in these proceedings for the sum of $601,482.80, to which the Receiver filed objections. These objections, after trial on the merits, were overruled and an order was made and entered on March 22, 1948, allowing the Bank's claim [R. 166-179]. This order contained an express finding that the Bank was entitled to participate as an unsecured creditor in all dividends paid on unsecured claims, and it was ordered that the Bank "shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors * * *" [R. 178-179]. The Receiver petitioned for a review of this order, and after the Referee's order was confirmed by the District Court, the Receiver appealed. On June 23, 1950, in case No. 12206, this Court handed down its affirming decision. This phase of the case is referred to by Appellant as the "Banker's Lien" litigation.

Upon confirmation of the plan of arrangement on July 30, 1948, the Receiver instigated the present proceeding by filing a petition with the Referee, seeking, on equitable grounds, to subordinate the claim of the Bank to the claims of all other creditors so as to deprive the Bank of the dividends to which it was entitled under the order referred to above [R. 58-62]. On January 20, 1949, some six months later, the Receiver filed a supplement to this petition [R. 63]. At the hearing the Bank objected to the jurisdiction of the Court to hear the controversy

and to the sufficiency of the petition and supplement [R. 79-81]. The objections of the Bank were sustained and the petition denied by the Referee by an order entered March 19, 1949 [R. 83]. The Receiver petitioned for review of this order, and after hearing, the District Court on January 20, 1950, entered an order affirming the order of the Referee and denying the Receiver's petition for review [R. 150-152]. The Receiver then took this appeal [R. 152-153].

Since the substance of the Receiver's petition and supplement and the pertinent provisions of the plan of arrangement and the order confirming it are fully set forth in the arguments in both briefs they will not be repeated here.

Questions Presented.

1. Whether the Referee and the District Court were correct in concluding that the Bankruptcy Court had not retained jurisdiction to hear and determine the issues attempted to be raised by the Receiver's petition and supplement.

2. Whether the Referee and the District Court were correct in concluding that the Receiver's petition and supplement did not state facts sufficient to require subordination of the Bank's claim.

3. Whether the Referee and the District Court were correct in concluding that the Receiver had no power or authority to prosecute the proceedings initiated by the petition and supplement.

Summary of Argument.

1. The Bankruptcy Court had no jurisdiction to entertain the Receiver's petition and to grant the relief sought therein.

   a. Since the question of the allowance of the Bank's claim and the Bank's right to dividends thereon had been decided and was on appeal at the time of the hearing on this petition, the Referee and the District Court were correct in holding that they were without jurisdiction to hear and determine the issues raised by the petition.

   b. Neither the plan of arrangement nor the order of confirmation contained a reservation of jurisdiction to determine the issues raised by the Receiver's petition and supplement thereto.

2. The petition and supplement thereto fail to allege facts sufficient to warrant the granting of the relief prayed for.

   a. The Receiver had no right, power, authority or duty to initiate the petition seeking subordination.

   b. The allegations in the petition and supplement thereto, even if assumed to be true, are not sufficient to warrant subordination of the Bank's claim to those of all creditors.

3. Since neither the Referee nor the District Court made any order either granting or refusing to grant leave to the Receiver to file an amended petition, there was no abuse of discretion in this respect by either the Referee or the District Court.

ARGUMENT.

I.

The Bankruptcy Court Had No Jurisdiction to Entertain the Receiver's Petition and to Grant the Relief Sought Therein.

(a) Since the Question of the Allowance of the Bank's Claim and the Bank's Right to Dividends Thereon Had Been Decided and Was on Appeal at the Time of the Hearing on This Petition, the Referee and the District Court Were Correct in Holding That They Were Without Jurisdiction to Hear and Determine the Isses Raised by the Petition.

As set forth in the statement of the case, the Receiver duly filed objections to the allowance of the Bank's claim [R. 20]. After full hearing in which the Receiver had every opportunity to raise all conceivable objections to the allowance, the objections were overruled by the Referee. The Receiver sought review of that order by the District Court [R. Case No. 12206, p. 93], and upon affirmance, on February 1, 1949, filed notice of appeal to this Court [R. Case No. 12206, p. 111]. The appeal was docketed in this Court on March 11, 1949, and the decision of this court affirming the District Court's decision announced on June 23, 1950. The Receiver has obtained a stay of mandate indicating his intention to petition the Supreme Court of the United States to grant certiorari.

The instant matter first came on for hearing before the Referee on March 2, 1949, about one month after the filing of the notice of appeal in the litigation referred to above. The Referee's order appealed from in this case was entered March 19, 1949 [R. 83]. The District Court's order was entered January 20, 1950, approxi-

mately nine months after the appeal in Case Number 12206 had been perfected [R. 150].

It is fundamental that the District Court and the Referee lose jurisdiction over a matter when an appeal is perfected to this Court. *Rothschild & Co. v. Marshall,* 51 F. 2d 897, 899 (C. C. A. 9, 1931). The only question is whether the contentions asserted by counsel for the Receiver in his petition here on review constituted objections to the allowance of the Bank's claim which were disposed of in Case Number 12206. We think they did.

The text writers and the cases provide ample support for the proposition that the Bankruptcy Court's power to subordinate claims or postpone the payment of dividends thereon constitutes an exercise, to a lesser degree, of its power to disallow claims entirely. Subordination is merely a means of accomplishing equity where the circumstances presented in objection to a claim are such that the severe penalty of complete disallowance should not be imposed.

The cases cited and relied upon by Appellant support this analysis. In *Manufacturer's Trust Co. v. Becker* (1949), 338 U. S. 304, 94 L. Ed. 99, 70 S. Ct. 127, the Supreme Court said (p. 309, fn. 7):

> Since the power of disallowance of claims, conferred on the bankruptcy court by §2 of the Act, 30 Stat. 545, 11 U. S. C., Sec. 11, embraces the rejection of claims "in whole or in part, according to the equities of the case" (*Pepper v. Litton,* 308 U. S. 295, 304-305 (1939)), the court may undoubtedly require limitation of the amount of claims in view of equitable considerations . . .

Professor Collier characterizes subordination as "relative disallowance" of a claim, saying (3 Collier, Bankruptcy, 14th Ed., Chap. 63.08, pp. 1809-1810):

> The compromise as worked out by judicial practice is a mode of relative disallowance, the judge-made counterpart to the priorities provided by the act, and is usually called "postponement" or "subordination." It is one of the valuable contributions of equity to the body of statutory bankruptcy law.

Since the Bank's claim had already been allowed in full when this petition was brought, it cannot by a subsequent order, collaterally attacking the allowance, be "relatively disallowed."

The test would seem to be whether the order of March 22, 1948, allowing the Bank's claim decided the question of parity. If it did, the lower court properly held that it had no jurisdiction to entertain this petition. While it is true that the grounds for subordination here urged by counsel for the Receiver were not raised by him at the time he objected to the Bank's claim, they should have been urged at that time (and undoubtedly would have been) if they had any substantial merit. To allow the Receiver to file and prosecute objections to the allowance of the Bank's claim, and, later, when he finds the objections overruled, on second thought to raise further objections in the form of a petition for subordination is to subject the claimant to undue harassment, and to give the Receiver two opportunities to accomplish the same result, *viz.:* practical disallowance of the Bank's claim.

It is significant that the Referee concluded as a matter of law in the order allowing the Bank's claim that the

> "Claimant is entitled to participate as an unsecured creditor in all dividends paid upon unsecured claims for the balance of its claim as so determined." [R. 178.]

and it was ordered that

> * * * the claim of Bank of America National Trust and Savings Association filed herein is hereby allowed in the sum of $601,482.80. * * * It is further ordered that said claimant *shall be entitled to dividends upon the said claim at the same rate paid to unsecured creditors.* [R. 178.] (Emphasis ours.)

It is submitted that an order such as the one requested by the Receiver in his petition to subordinate in this case is completely inconsistent with the above quoted order that the "claimant shall be entitled to dividends upon the said claim" and the finding that "claimant is entitled to participate as an unsecured creditor in all dividends paid upon unsecured claims." Certainly the plain intendment of the finding was to permit the Bank to participate as an unsecured creditor on a parity with and at the same rate as the other creditors. A subordinated claimant cannot possibly "be entitled to dividends upon the said claim at the same rate paid to unsecured creditors." The Receiver is now in the position of arguing that the Bank is not entitled to dividends at the same rate as other creditors, but at a rate of zero until all other creditors are paid. This position is not in the least compatible with the order allowing the Bank's claim.

The conclusion is inescapable from the foregoing that the subject matter of the instant petition was embraced in and the issue decided in the other proceeding which was on appeal at the time the Referee and the District Court decided they did not have jurisdiction to entertain this proceeding.

In his brief at page 19 the Receiver says he is "seeking to defer any payment of dividends on the Bank's claim until the claims of other creditors have been paid." In his petition the Receiver seeks a ruling that the Bank "not participate in any dividends from the said $75,000 until all other creditors are paid in full." [R. 65.] Such relief, if granted, would certainly deprive the Bank of its right under the existing unchallengeable order to "be entitled to dividends upon the said claim at the same rate paid to unsecured creditors."

The order allowing the Bank's claim went further than mere allowance, and, by necessary implication determined the Bank's right to a dividend on a parity with other creditors. Unless the Supreme Court of the United States grants certiorari and reverses the existing decision of this Court, the Receiver is foreclosed from attempting to deprive the Bank of its established right to dividends at the same rate as other creditors. He should not be permitted to attack the validity of the previous order collaterally under the guise of a petition to subordinate.

The trial court was therefore clearly correct in sustaining the Bank's jurisdictional objection in this case on the ground that the issues raised by the petition were then pending for decision in the Court of Appeals.

(b) Neither the Plan of Arrangement nor the Order of Confirmation Contained a Reservation of Jurisdiction to Hear and Determine the Issues Raised by Receiver's Petition and Supplement Thereto; in the Absence of Such a Reservation the Court Had No Jurisdiction.

Section 367 of the Bankruptcy Act (11 U. S. C., Sec. 767) provides that upon confirmation of an arrangement and the payment of costs and expenses and disbursement of the consideration provided by the plan, the case shall be dismissed "except as otherwise provided in Sections 369 and 370 of this Act."

Section 368 (11 U. S. C., Sec. 768) provides that the Court shall retain jurisdiction of the proceedings if so provided in the arrangement. Section 369 (11 U. S. C., Sec. 769) provides that the Court shall in any event retain jurisdiction until the final allowance or disallowance of all debts affected by the arrangement, and Section 370 (11 U. S. C., Sec. 670) provides that upon the allowance of debts which have been disputed the consideration shall be disbursed.

It is clear that under these provisions of the statute we must look to the order confirming the second amended plan of arrangement to determine what jurisdiction was reserved by the Court at that time [R. 40-44]. *In re Gordon,* 44 Fed. Supp. 581, 582 (D. C., N. D., N. Y., 1941). The only reservation of jurisdiction contained in the order confirming the plan is as follows [R. 43]:

> IT IS FURTHER ORDERED that this court retains and reserves jurisdiction to determine the amount and validity of all claims of creditors, both secured and unsecured and the classification of said claims, and all objections that have heretofore been made or

> that may be made in regard thereto, with a like effect and power as if the above-named debtor had been adjudged a bankrupt and George T. Goggin were the acting trustee in bankruptcy; and that George T. Goggin, as receiver and disbursing agent, shall have the right to object to any and all claims with like effect as if he were acting in the capacity of a trustee in bankruptcy.

This order clearly does not contain a reservation of jurisdiction to hear the present controversy. The only jurisdiction reserved is the jurisdiction to determine objections to claims. If the Receiver's petition is considered as an objection to the claim of the Bank, then conceivably the Court might have had jurisdiction to hear it except for the pendency of the appeal from the order allowing the claim, but Counsel, in an attempt to avoid the dilemma in which he finds himself argues (Br. pp. 19-20) that the Receiver's petition is not an objection to the claim. He cannot, therefore, successfully rely upon this provision of the order to support jurisdiction of the Court.

The Court also reserved jurisdiction in its order to determine "the classification of said claims." Counsel infers, apparently (Br. p. 26), that the matter here on appeal is a petition to classify the Bank's claim. But obviously this language was intended to do no more than reserve jurisdiction to determine into which of the specified classes of claims established by the plan a particular claim belonged. Article I of the plan contemplated classification of claims into classes A to D [R. 29-30]. The Receiver admits (Br. p. 21) that the Bank's claim fell within Class D, and no contention to the contrary has ever been made. There is no class denominated "subordi-

nated claims" contemplated by the plan. It is only by severely straining the plain intendment of the language that this reservation can be said to refer to anything else than the division of claims into Classes A, B, C and D.

The Receiver seeks to base the Court's jurisdiction upon the provision in the *plan of arrangement* that the Court should retain jurisdiction to pass upon all controversies with creditors and third persons with like effect as if there had been an adjudication in bankruptcy.

We think that this argument is untenable and not supported by the record. The controversy presented by the Receiver's petition in essence is not a controversy with a creditor. It is a controversy *between* creditors because the Receiver is attempting to assert that some creditors have an equitable right to receive dividends before dividends shall be paid upon the Bank's claim. The entire petition and supplement thereto are based apparently upon some theory that the Bank by continuing to extend credit to the debtor while insolvent, and by giving out credit information to prospective creditors, has estopped itself, in so far as those creditors who relied upon such information are concerned, to participate in dividends with them on a parity. Assuming that these facts are true, they would, at most, give rise to a cause of action against the Bank in the individual creditors who relied upon the credit information. The issue remains a controversy between creditors, even though instigated by the Receiver who in an excess of zeal has assumed the role of special representative of one group of creditors seeking an advantage over another. There is no reservation of jurisdiction to determine such controversies *between* creditors.

It is significant that the consents of the individual creditors to the plan [R. 57] contained an express reservation that

> This consent * * * shall not in any manner prejudice the rights, defenses or cause of action that the undersigned, as a creditor, would have * * * or any creditor of Salsbury Motors, Inc., would have in the event that Salsbury Motors, Inc., were adjudged a bankrupt * * *

And the plan itself provided [Article IV, R. 48] that:

> There shall remain vested in the creditors, such rights of actions and claims as they may have at this time against parties other than the debtors, exclusive of the matters settled and compromised in Article V herein, without limiting any of the foregoing provisions contained in this Article, the order confirming the second amended plan of arrangement and the acceptance by creditors of the same, shall be without prejudice as to the rights of creditors, receiver, his successor in interest, or the bankrupt estate, in connection with any and all proceedings or claims existing or now pending or that may be instituted against any person or corporation, except the rights, claims and demands settled and compromised under Article V herein.

It is abundantly clear from the foregoing that the creditors retained all causes of action not expressly foreclosed by their consents and adoption of the plan. There was no submission of these causes of action to the jurisdiction of the Bankruptcy Court. On the contrary, the plain intention of the creditors was to preserve their relative legal positions among themselves in *status quo*. There is nothing in the consents, the plan or the order of confirmation indicating any intention on anyone's part

that the Court should assume jurisdition to litigate causes of action vested in the individual creditors. On the contrary the express retention of rights indicates a clear intent that the creditors are to remain free to prosecute such causes of action as they may have in a forum of their own choosing. There is an express negation of any desire on their part that the Receiver usurp and prosecute their causes of action for them as a sort of informal "next friend."

Notwithstanding the assertions and intimations of counsel to the contrary (Br. p. 22), the plan of arrangement did *not* provide either that the claim of the Bank should be subordinated to that of other creditors or that the Receiver should initiate proceedings to that end. The most that can be said on that score is that there was a provision in Article V(c) of the second amended plan [R. 51-52] to the effect that the controversies then pending between the Receiver and Northrop Aircraft Corporation, settled by the plan, should not be affected as a result of any subordination of the claim of the Bank to the claims of other creditors. This limitation, however, related only to the Receiver's compromise with Northrop Aircraft Corporation and did not apply to any other controversy.

Counsel relies heavily upon the fact that the plan of arrangement provided in Article IV that there remain vested in George T. Goggin, as Receiver and disbursing agent, all causes of action that could or would vest in George T. Goggin as Trustee in the event of an adjudication, with full right and power to prosecute any such action or causes of action that would vest in him as a Trustee in Bankruptcy (Br. pp. 22-26). This provision, however, makes no reference to *jurisdiction of the Bankruptcy Court*

to entertain such actions or proceedings by the Receiver, and neither does the order of confirmation [R. 40-44].

We have fully discussed the provisions of both the plan and the order pertaining to jurisdiction because of counsel's apparent contention that in some manner a reservation of jurisdiction can be accomplished merely by including it in the plan. We think, however, that the law is clear that the extent of the jurisdiction of the Court must be determined by the provisions of the order confirming the plan and *the jurisdiction reserved by that order.* This is the effect of Sections 367, 368 and 369 of the Bankruptcy Act above referred to and the interpretation placed upon those sections by decisions of the Courts.

The order confirming the second amended plan of arrangement was a judgment from which an appeal would lie. (Bankruptcy Act, Secs. 39(c), 24. Rule 54a, Federal Rules of Civil Procedure.)

If the order failed to reserve jurisdiction in the manner contemplated by the plan of arrangement, any creditor interested might have prosecuted an appeal therefrom. In the absence of such an appeal, the order became final and the jurisdiction must be determined by its provisions. This very point was decided in *Prudence Realization Corp. v. Ferris,* 323 U. S. 650, 654, 89 L. Ed. 528, 533, in which the Supreme Court said:

> This case is not the Geist Case. Here the bankruptcy court neither considered the question of parity nor retained jurisdiction to consider it. *The order of confirmation contained no provision for retention of jurisdiction to decide the parity question* as did the Geist order. Nor did the closing of the reorganiza-

tion reserve jurisdiction, as did the Geist closing order. The provisions for disposition of the impounded funds in case subordination be determined are much more elaborate than the Geist Case discloses. In short, while the provisions for adjudication of the parity question in the Geist Case clearly contemplated determination of it as part of the reorganization proceedings by the Bankruptcy Court itself, in the present case the Bankruptcy Court washed its hands of the problem and left the parties to litigate the question in another forum. For it is not questioned that the state court was a "Court of competent jurisdiction" for adjudicating the claim of parity.

To be sure, the Securities and Exchange Commission as *amicus curiae,* suggests that the Bankruptcy Court was in error in failing to retain jurisdiction for determining this aspect of distribution. But the different treatment of the same problem by the same court in the Geist Case and in this, together with acquiescence by the petitioner in the closing order without seeking a review of the nonretention of jurisdiction, give ground for believing that the arrangement was the product of bargaining between the parties. *In any event, since no appeal was taken, it is not now open to find error by the Bankruptcy Court in failing to retain jurisdiction.* The order confirming the plan or reorganization is *res judicata.* [Emphasis ours.]

Appellant makes the bald assertion (Br. p. 32) that "in the instant case it was definitely contemplated that any subordination of claims should be a part of the proceedings to be conducted by the Bankruptcy Court, and that the *Ferris* case, *supra,* is therefore not controlling. But we look in vain for any language in the plan or the order

to support counsel's assertion. We find, instead, an express reservation to the creditors of their causes of action, and an expression that the plan and the order of confirmation should be without prejudice to such rights. Clearly, the rules announced in the *Ferris* case are applicable here.

In *In re Wedgewood Hotel Co.,* 125 F. 2d 327 (C. C. A. 7, 1942), the petitioner, a creditor, sought to have the Court order the trustee under a Section 77b proceeding to accept certain provisions of a trust agreement drawn in accordance with the petitioner's interpretation of the plan of reorganization. The order confirming the plan of reorganization stated:

> The Court reserves jurisdiction herein to enter such further orders as may hereafter be deemed necessary or proper in connection with carrying out the terms and provisions of the plan of reorganization as amended, and terminating this cause.

The Court said at page 329:

> Admittedly, the relief sought in the instant petition is foreign to the matter over which the court expressly reserved jurisdiction; that is, disputes relative to the ownership of first mortgage bonds and the issuance of new securities therefor. It is plain that there is nothing in the final decree by which the court expressly retained jurisdiction over the subject matter of the petition. We do not understand petitioner to controvert this appraisement of the final decree, but it is contended the court has an implied or inherent jurisdiction to enforce its final decree and to aid in carrying out the plan. Assuming such to be the law, it affords no support to petitioner for the reason that the relief sought was foreign to, and in contravention of, the plan of reorganization as assented to by

> the creditors and approved by the court. In fact, the petition plainly discloses that another and different plan of reorganization was proposed. If consummated, the result would be a new plan of reorganization, not assented to by the creditors, superimposed upon the plan, assented to and confirmed.

This decision is directly applicable to the facts here. The plan of arrangement did not provide for a subordination of the Bank's claim. The Receiver in effect is arguing that the Court must have retained jurisdiction to superimpose a different plan from that which was confirmed, namely, to direct a plan in which the Bank's claim would be subordinated to the claims of other creditors.

In the case of *In re East Boston Coal Co.* (D. C. Pa.), 47 Fed. Supp. 593, the Court said:

> It is clear that it is contemplated by this section [Section 224(2), 11 U. S. C., Sec. 624(2)] that the Court shall retain jurisdiction of the debtor until consummation of the plan of reorganization in order to insure that the provisions of the plan of reorganization are carried out. [Citations.] However, *there is nothing in the Bankruptcy Act to indicate that the Court retains jurisdiction of the debtor for the purpose of disposing of any controversy which might arise between the debtor and third parties* relating to matters other than the plan of reorganization itself.
> * * *
>
> However, in view of the fact that the petition reveals on its face that the controversy is not one which arises under the provisions of the plan of reorganization, and, as I have stated, that this Court is without jurisdiction to determine the matter therein referred

> to, I will dismiss the petition at this time rather than delay the final determination of the matter until a further hearing is had. [Emphasis ours.]

It is true that the foregoing cases involve proceedings for reorganization under Chapter X of the Bankruptcy Act rather than Chapter XI. But the provisions and the objectives of the two chapters are so similar that these decisions may be said to be controlling. In an attempt to distinguish these cases, Counsel argues (Br. pp. 32-33) that the Bankruptcy Court has more jurisdiction during the interval between the confirmation of the plan and the final order discharging the Receiver. It is true that there are certain tasks to perform during the interval for which jurisdiction is conferred by the statute. (See *e.g.* 11 U. S. C., Sec. 769.) But we have found no authority for the proposition that the Bankruptcy Court has a general reservoir of jurisdiction upon which it can draw during the interval but which is exhausted by the final order closing the estate.

In *In re Gordon,* 44 Fed. Supp. 581 (D. C. S. D., N. Y. 1942), the court discussed this question and said (p. 582):

> Where by the arrangement jurisdiction is not retained there is nothing between "dismissal" and "closing the estate" except the exercise of the powers conferred by Sections 369 and 370.

The Receiver apparently argues (Br. pp. 34-35) that the Court below had an "inherent" jurisdiction to entertain and decide the issues raised by the petition as a part

of its power to order distribution of funds on hand. But the Bankruptcy Court is a statutory court which has only such jurisdiction as is granted to it by Congress. The Receiver seeks comfort in Section 369 of the Bankruptcy Act (11 U. S. C., Sec. 769), but it is clear that the present controversy does not fall within that section. Section 369 constitutes merely a retention of jurisdiction until the final allowance or disallowance of all debts which have been proved, but not allowed or disallowed or are disputed or unliquidated. The claim of the Bank in the instant proceeding had been proved and allowed before the instant petition was filed. This section, like the express reservation in the order of confirmation, relates only to the allowance or disallowance of claims. It cannot be stretched to include the determination of a controversy between creditors such as this.

In the *Gordon* case, *supra,* the debtor, after confirmation of an arrangement under Chapter XI and after default in his obligations under the plan, sought to compel distribution of the funds in the hands of the distributing agent. The Court said (p. 582):

> These two sections [357(7), 368] of the Bankruptcy Act bestow upon the parties to an arrangement the option whether to continue the court's jurisdiction or not (except in the respects hereinafter mentioned). The choice has important and specific significance. If it is in favor of continuing jurisdiction it brings into play the provisions of section 377 which, in the event of default in performance of the terms of an arrangement, permit an adjudication in bank-

ruptcy if the proceeding is brought under section 322, and compel such an adjudication if the proceeding is brought under section 321. Retention of jurisdiction also makes section 344 operative after confirmation.

The arrangement under consideration did not provide for the retention of jurisdiction. The plain implication from sections 357(7) and 368 is that *where provision for retention is not made in the arrangement the court is without jurisdiction except as the statute otherwise directs.* * * *

It is my conclusion that the debtor's dilemma cannot be solved by the instant application; that the Bankruptcy Act does not provide judicial supervision over post confirmation claims and post confirmation conduct where jurisdiction is not retained in the court by the arrangement; and, therefore, that the petition must be dismissed. [Emphasis ours.]

In summary on this point, therefore, we respectfully submit that, first, the order of confirmation does not reserve jurisdiction; second, the amended plan of arrangement did not contemplate reservation of jurisdiction for this purpose; third, the plan and the consents thereto contained a clear expression of intention to reserve to the consenting creditors any causes of action they might have; and fourth, notwithstanding the terms of the plan, the order of confirmation is controlling, and if it did not conform to the plan an appeal should have been taken. We respectfully submit that the Court below correctly determined that it had no jurisdiction to hear the allegations of the Receiver's petition and supplement thereto.

II.

The Petition and Supplement Thereto Fail to Allege Facts Sufficient to Warrant the Granting of the Relief Prayed for.

(a) The Receiver Had No Right, Power or Authority to Initiate the Current Proceedings.

It is the Appellee's position, supported by the record and by the authorities, that the Receiver himself had no authority to initiate these proceedings because the order of confirmation of the plan does not grant him such authority, and because the subject matter of the petition is not properly the basis of a cause of action in a receiver, a disbursing agent or a trustee.

The only reservation of authority to George T. Goggin as Receiver and disbursing agent is the following excerpt from the confirmation order:

> and that George T. Goggin, as Receiver and disbursing agent, shall have the right to object to any and all claims with like effect as if he were acting in the capacity of a trustee in bankruptcy. [R. 43].

Counsel for the Receiver is here faced with a dilemma similar to the one heretofore discussed. If the petition of the Receiver constitutes an objection to the Bank's claim, the Receiver might conceivably have the power and authority to prosecute it, but, as we have previously pointed out, the Court would have no jurisdiction to hear such objections while the appeal is pending. On the other hand, if the Receiver's petition does not constitute an objection to the Bank's claim, there is no power or authority reserved to the Receiver to prosecute it in any event.

Here again the assertion is made by the Receiver that he has authority because the plan provided that there re-

main vested in George T. Goggin, as Receiver and disbursing agent, all causes of action that could or would vest in Goggin as Trustee in Bankruptcy in the event that he were appointed as such (Br. pp. 38, *et seq.*). The plan of arrangement in Article IV, however, also provides that *"there shall remain vested in the creditors* such rights of action and claims as they may have at this time against parties other than the debtor exclusive of the matters settled and compromised in Article V herein." (The reference to Article V is to a controversy with Northrop Aircraft Corporation) [R. 48].

The plan itself thus contemplated that there might be rights or causes of action in favor of creditors which would not be vested in a trustee in bankruptcy in the event that a trustee should be appointed. The plan expressly provided that those rights which might become vested in a trustee in bankruptcy would remain vested in Goggin, and those rights of creditors against parties other than the debtor (which, of course, would include the Bank) should remain vested in the creditors themselves. It cannot seriously be argued that the plan of arrangement contemplated that George T. Goggin, by virtue of his office as Receiver and disbursing agent, should have the power or authority to initiate proceedings seeking to exercise rights which, by their very nature, exist only between certain creditors or between certain creditors and third persons.

It is further to be noted that the subject matter of the Receiver's petition is not properly the basis of a cause of action or proceeding by a receiver, a disbursing agent or a trustee in bankruptcy. The petition asserts generally that for equitable reasons the claim of the Bank should be subordinated to the claims of other creditors, and the alleged basis for this assertion is the contention that rep-

resentations as to the financial condition of the debtor were made by the Bank to certain creditors.

If we assume for the moment that in a proper case such facts might constitute basis for relief to one or more creditors who could establish that they themselves were individually misled to their prejudice by some action or non-action of the Bank, it is apparent that such grounds for relief would be vested only in the creditors who were actually injured by the alleged misrepresentation. Clearly the trustee in bankruptcy, as a representative of *all* creditors, would have no right to assert any such cause of action. From its very nature the cause of action, if any, would exist only in the creditors who had been prejudiced.

This principle is demonstrated in the case of *Wallace v. Ohio Valley Bank,* 2 F. 2d 53 (C. C. A. 4, 1924), in which the Court said (p. 56):

> Another of the trustee's exceptions goes to the entire claim of the bank. It alleges that the bank, for the purpose of getting undeserved credit for the bankrupt, knowingly made false statements as to the latter's financial condition, and that those to whom they were made acted upon them and suffered thereby. The trustee argues that in consequence the bank is not entitled to receive anything from the bankrupt estate until after its other creditors have been paid in full. To sustain this exception the trustee relies upon the telegram and the letter sent by the bank to Greenbaum, and as we understand the record upon them alone. *If they made the bank liable to any one, as to which we intimate no opinion, it was to Greenbaum. If anyone was deceived by them it was Greenbaum, and it alone suffered from them. The money the bankrupt obtained from it went to swell the bank-*

rupt's resources, and to a greater or less extent benefited the bankrupt's other creditors. As representing them, the trustee has not been hurt. Doubtless a case can be conceived in which a creditor of a debtor in failing circumstances may for its own purposes seek by knowingly false statements to obtain credit for the debtor from any or from all who may deal with the latter. Under such circumstances it may be that the trustee, as representing the creditors generally, has the right to insist that, in the distribution of the bankrupt's estate, the improper action of the one creditor shall estop it from competing with its victims; but such rule of law, *if it exists,* has no application to the instant case. The learned court below was right in overruling this exception. (Emphasis ours.)

The same ruling was made in the case of *J. Henry Schroder Banking Corporation, et al. v. L. S. Brach Mfg. Corp.,* 78 F. 2d 530 (C. C. A. 7, 1935), where the Court said (p. 532):

> This note is held subject to an agreement dated as of April 9, 1931, between J. Henry Schroder Banking Corporation, Franklin-Washington Trust Company, and L. S. Brach Manufacturing Corporation.
>
> Schroder's claim in bankruptcy was upon the $30,000 note and for dividends to be paid in the bankruptcy proceedings upon the $49,562.50 note to Brach, until the total amount of dividends received by it on both notes equaled $30,000.
>
> Schroder petitioned the court for an order directing the referee to pay dividends on the claim filed by Brach until its claim on the $30,000 note and interest had been paid in full. Brach filed its answer objecting to the petition on the ground that the conflict

> between it and Schroder was collateral to and not determinable in the bankruptcy proceedings. The trustee also objected to the Brach claim on the ground that the agreement between Brach and Schroder gave the latter preference in payments made thereon. *This action of the trustee was uncalled for and outside the scope of his duties.* [Emphasis ours.]

Counsel for the Receiver argues strenuously (Br. pp. 39-42) that a Bankruptcy Court has the general power and jurisdiction to subordinate the payment of dividends on claims as between creditors of the same class. We have no quarrel with the authorities on this point. As counsel has pointed out, we conceded before the lower courts that a Bankruptcy Court has the general power and jurisdiction in a pending bankruptcy proceeding to adjudicate such controversies. Our point is that *in this proceeding for an arrangement and under the order of confirmation entered by the Referee*, jurisdiction to determine such controversies has not been reserved, and under the statute and decisions the Court's general equity powers and general bankruptcy powers have been limited to the jurisdiction reserved by the order confirming the plan. We fail to see how the authorities cited by counsel on this point confer upon the Receiver any authority to prosecute a proceeding such as this.

There is a valid distinction between those cases where the inequitable conduct is of a type which, by its nature, must have affected *all* creditors who did business with the debtor, and those cases where the ground of subordination is founded upon contractual or other relations between *some* of the creditors only. Examples of the former type are founded upon the parent-subsidiary relationship,

and other cases in which a party with a fiduciary relationship to the debtor commits a breach constituting inequitable conduct prejudicial to *all* persons extending credit to the bankrupt. (See, *e.g., In re Loewer's Gambrinus Brewery Co.,* 167 F. 2d 318 (C. C. A. 2, 1948).) In this type of case, the courts will, if the conduct is unconscionable, either disallow the claim or subordinate it, when objections to the allowance of claims are interposed by the trustees. But we have found no authority, and appellant has cited none, supporting the power of a trustee gratuitously to intermeddle between creditors, taking the part of one group of creditors against another where, as here, the alleged inequitable conduct arises from personal relations between them and does not affect those not parties to the transaction. Indeed, the cases hold that such matters are none of the trustee's business. *Wallace v. Ohio Valley Bank, supra; J. Henry Schroder Banking Corp. v. L. S. Brach Mfg. Corp., supra;* see also *Equitable Holding Corp. v. Woody,* 63 F. 2d 751 (C. C. A. 2, 1933).

Matter of Bowman Hardware & Electric Co., 67 F. 2d 792 (C. C. A. 7, 1933), is an illustration of the proper method of raising the issue in this type of case. In that case the objection was interposed by a mercantile creditor on behalf of himself and others similarly situated. The Court held the conduct did not warrant subordination.

This court, in *Ingram v. Lehr,* 41 F. 2d 169, 170 (C. C. A. 9, 1930) indicated its doubt that a trustee can, on behalf of one creditor assert an objection to a claim on the ground that another creditor had acted inequitably toward him.

In summary upon this point, therefore, we respectfully submit that George T. Goggin, as Receiver and disbursing

agent, had no authority to initiate or prosecute his attempted petition for the reason that he was not granted any such authority by the order confirming the second amended plan of arrangement and for the further reason that even if he were a trustee in bankruptcy the alleged inequitable conduct is of such a nature that he would have no right or authority to initiate the proceeding.

(b) The Allegations in the Petition and Supplement Thereto, Even if Assumed to Be True, Are Not Sufficient to Warrant Subordination of the Bank's Claim to Those of All Creditors.

One of the points urged by the Bank before the Referee was that the facts alleged in the Receiver's original petition filed July 30, 1948 [R. 58], and the supplement thereto filed January 20, 1949 [R. 63] were insufficient as a matter of law to constitute any grounds for relief.

Counsel for the Receiver has attempted to make a point of the fact that during the argument on March 2, 1949, the Referee indicated that he would limit his order to jurisdictional grounds, and at a later time changed his mind and predicated it upon all of the grounds asserted by Appellee (Br. 45). We think it well to discuss this point and the matter of the amended petition before discussing the sufficiency of the petition on its merits. As we view it, no Court is bound by any colloquy with counsel during an argument on propositions of law. In any event, we think that the record shows that the Referee was of the opinion at the time of argument on March 2 that the Receiver's petition was insufficient [R. 158]. If it were possible to draft an amendment which would state a cause of action the Receiver could as well have done

that as to file a motion to reconsider, supported by a brief and subsequently followed by lengthy objections to the form of the order, without at any time making any proper application for leave to file an amended petition.

Counsel "strenuously urges" (Br. p. 45) that it was error for the courts below to refuse to grant the Receiver permission to amend his petition, and suggests in his statement of the case (Br. p. 7) that there was an abuse of discretion in such refusal. This argument is untenable for the simple reason that nowhere does the record show that either of the courts below made any order, either granting or refusing to grant leave to file the amended petition. There can be no abuse of discretion where there has been no exercise of discretion. At no time did counsel make a proper motion for leave to amend, or give any notice that he intended to make such a motion. From his tactics with reference to the proposed amendment, the inference is plain that Counsel was extremely reluctant to file it at all, and submitted it only after the Referee had announced his ruling. The amendment, having been filed on April 6, 1949, after the Referee's order here appealed from had been signed [R. 85, 107], is not properly a part of the record on this appeal. The District Court made no order with respect to the amendment at all, because there was no order with respect to it for him to review.

We believe that the Receiver's original petition and the supplement thereto do not state any grounds for equitable relief of any kind, let alone that prayed for by the Receiver, and that a consideration of the allegations of the petition and supplement leads inescapably to this conclusion.

We will review briefly the allegations of the original petition [R. 58] in order to indicate its utter lack of allegations sufficient to show any basis for equitable relief. Paragraph 2 alleges in substance that commencing in early 1946 the Bank received regular statements from the debtor showing that it was insolvent and losing money, that the debtor was in default, and the Bank continued to allow it to operate. Paragraph 3 alleges that the Bank knowingly and deliberately *permitted the debtor to continue in operation,* which caused a continued extension of credit by other creditors, and that the Bank, having withheld enforcement of its claims, is as a matter of law estopped from contending that it is entitled to dividends. Paragraph 4 alleges that as a matter of law the Bank by its conduct is estopped from participating on a parity with other creditors, and in Paragraph 5 it is alleged that the Bank, having lulled other creditors into a feeling of security by inducing their continued extension of credit, *caused by the Bank's failure to declare a default,* is not entitled to share until all other creditors are paid.

We think that we need not make an extended argument on the insufficiency of the original petition. A creditor's claim cannot be defeated even though the creditor extended the credit knowing of the insolvency, and, in fact, immediately prior to bankruptcy. The credit that is extended increases the value of a debtor's estate. It is inconceivable that anyone could argue with any degree of sincerity that because a creditor does not declare a default and throw a debtor into bankruptcy, even though he knows of his insolvency, the creditor is thereby to be deprived of a claim for his share of the assets of the bankrupt. The Receiver cites no cases supporting his

position in this respect, and, indeed, appears to have abandoned this ground entirely.

The original petition also alleges that the Bank was the only creditor that had notice that Northrop Aircraft Corporation did not intend to pay all of the debts of Salsbury Motors, Inc., and that therefore it would be inequitable to allow the Bank to participate in dividends payable from the $75,000 collected from Northrop Aircraft Corporation in a compromise with the Receiver. We think that the answer to this assertion is found in the case of *William H. Moore, Jr., Trustee, etc. v. O. S. Bay,* 284 U. S. 4, 5, 76 L. Ed. 133, in which the Supreme Court said (p. 5):

> The rights of the trustee by subrogation are to be enforced for the benefit of the estate. The Circuit Courts of Appeal seem generally to agree, as the language of the Bankruptcy Act appears to us to imply very plainly, that *what thus is recovered for the benefit of the estate is to be distributed in dividends of an equal percentum on all allowed claims, except such as have priority or are secured.* [Emphasis ours.]

It is fundamental that the recovery by the Receiver of the $75,000 redounds to the benefit of the estate as a whole, and not to any particular group of creditors. The mere fact that the Bank in a separate action against Northrop might not have been able to recover is not a ground for depriving the Bank of its right to a dividend on its claim. The Receiver's theory, if adopted, would require the tracing of each asset in an estate to its particular source and a determination that each creditor claiming a dividend out of this asset could have recovered directly from the source of the assets. Such a cumber-

some requirement finds no support in the Bankruptcy Act or the cases.

The supplement to the petition of the Receiver contains additional allegations of the same character but equally without substance or merit. That document, dated January 20, 1949 [R. 63], alleges in substance that between January 1 and August 20, 1947, the Bank knew that Salsbury was insolvent and that it was unable to meet and pay its current obligations to the Bank, that Northrop Aircraft Corporation, the owner of the stock, would not pay or guarantee its obligations and had determined that it would not advance additional funds, and that Salsbury was not paying to unsecured creditors the current obligations as they became due.

If every individual who failed to pay his current obligations as they became due at one time or another was immediately thrown into bankruptcy, the Bankruptcy courts would be tremendously crowded. The idea that a creditor may be penalized by disallowance or subordination because he tolerates a default and gives the debtor an opportunity to work out of his difficulties is a novel one, and one that we are quite sure has not been given sanction by the courts.

The supplement to the petition further alleges that notwithstanding the knowledge of the Bank that the debtor was not paying its bills, the Bank, in response to credit inquiries of some persons who are creditors in the proceeding, and in response to inquiries from credit agencies, gave information that the financial condition of Salsbury was satisfactory and did not disclose that some obligations to the Bank were in default or had been extended or renewed, and did not disclose that the deed of trust held

by the Bank (which was recorded as required by law), secured all indebtedness of the debtor to the Bank. This document further alleges that certain unpaid creditors extended credit to the debtor in reliance upon the position taken by the Bank and the misinformation circulated by it in connection with the financial condition of the debtor.

Again, without any extended discussion, we respectfully submit that the allegations of the supplement to the petition are insufficient to constitute any basis for equitable relief. Such a petition, if it has any legal justification whatever, must be predicated upon allegations of facts which are legally sufficient to constitute fraud. The petition and supplement, however, are entirely lacking in such allegations. It is significant that in all of the allegations of the petition and supplement thereto the Receiver does not anywhere allege that any statement made by the Bank was untrue or that any specified creditor was in fact damaged by reliance upon any statement made by or attributed to the Bank.

For the convenience of the Court we quote briefly from the authorities on this point.

In the matter of *In re Bowman Hardware & Electric Co.*, 67 F. 2d 792 (C. C. A. 7, 1933), the court said (p. 794):

> Before a general creditor's claim against the bankrupt may be disallowed or its status lowered, it must appear that said creditor has been guilty of some act involving moral turpitude or some breach of duty or some misrepresentation whereby other creditors were deceived *to their damage*. In the instant case the absence of any evidence showing that other creditors were damaged by appellant's action, conceding for the moment that such action amounted to fraud, is fatal

to the asserted priority of all other general creditors save Van Camp Hardware and Iron Company. * * *

The order of the District Court is reversed, with directions to allow appellant's claim on an equal footing with other unsecured creditors save only that the trustee shall pay to Van Camp Company out of appellant's distributive share a sum equal to the balance of Van Camp Company's claim, after deducting its dividend.

In the case of *Ingram v. Lehr,* 41 F. 2d 169 (C. C. A. 9, 1930), this Court said (p. 170):

Bankruptcy proceedings are in equity and undoubtedly a claim is subject to the general rule that "he who has done iniquity shall not have equity." But we do not find in the understanding here the quality of moral obliquity: it might have operated as a constructive fraud, but we do not think actual fraud was intended. To the contrary, it would seem that both parties were of the opinion that if the business could be carried forward by Hockinson he would be able to make a success of it and ultimately pay all of his debts, both those which then existed and those which he might incur. Assuming that hope or expectation to have been a reasonable one, the plan was not inherently fraudulent. Nor for the benefit of others contemplating giving Hockinson credit was the claimant under any legal obligation to make public the fact that Hockinson owed him. *Crowder v. Allen-West Comm. Co.* (C. C. A.), 213 F. 177, 183, 184. If subsequently, as there is some testimony tending to show, the claimant, by stating that he had no claim, affirmatively deceived one who was considering the matter of extending credit to Hockinson, the claimant might be estopped from asserting his claim *as against that creditor.* But even so, other creditors could not in-

> voke the defense; the claim might still be provable against the estate and be good as against all other creditors. [Emphasis ours.]

And in the leading case of *Crowder v. Allen-West Commission Co.,* 213 Fed. 177 (C. C. A. 8, 1914), the Court said (p. 184):

> A creditor must have been guilty of some moral turpitude or some breach of duty by which other creditors were deceived, to their damage, to constitute such a fraud as will estop him from sharing with them in the distribution of the proceeds of the estate of his debtor in bankruptcy. A willful intent to deceive or such gross negligence as is tantamount thereto is an essential element of such an estoppel.
>
> A creditor of an insolvent debtor is a competitor of all his other creditors. *He stands in no fiduciary or contractual relation to them and owes them no duty to inform them of his debtor's financial condition, his insolvency, or of the amount of his indebtedness to him. Foster v. McAlester,* 114 Fed. 145, 151, 52 C.C.A. 107, 113. There was therefore no fraud or breach of duty in the failure of the commission company to inform the other creditors in this regard. [Emphasis ours.]

The Supreme Court of the United States in two recent cases has had occasion to review the doctrine of equitable subordination. In each of these cases, that Court has declined to subordinate or disallow the claims, indicating plainly that if the claim is the outgrowth of legitimate, good faith business transactions, neither in design nor effect producing injury, it will be allowed to participate. *Comstock v. Institutional Investors,* 335 U. S. 211, 230, 92 L. Ed. 1911, 1923 (1947); *Manufacturers Trust Co v. Becker,* 338 U. S. 304, 94 L. Ed. 99, 70 S. Ct. 127 (1949).

The Comstock case distinguished *Pepper v. Lytton,* 308 U. S. 295, and *Taylor v. Standard Gas & Electric Co.* (Deep Rock Case), 306 U. S. 307, cited by appellant, on their facts, but the dissenting opinion relied upon these cases. This clearly indicates that the Supreme Court intended to limit substantially the application of the subordination doctrine.

We fail to appreciate the "particular significance" of the case of *Columbia Gas & Electric Corporation v. U. S.* 151 F. 2d 461, reh. den. 153 F. 2d 101, cert. den. 329 U. S. 737 (C. A. A. 6, 1945) quoted at length by Appellant (Br. pp. 48-49), in view of the fact that the petition in this case contains no allegations of "illegal or inequitable conduct" similar to the conduct involved in the *Columbia* case.

Counsel in his conclusion (Br. pp. 50-51) implies that there is something reprehensible in the Bank's collecting as much of its debt as it was legally entitled to collect. Our only comment is that these remarks are wholly immaterial to the issues raised on this appeal, and insofar as they are based upon matters outside this record, are improper.

Conclusion.

It is submitted that the decision of the lower court was correct and should be affirmed. The Bankruptcy Court was without jurisdiction to hear and determine the issues raised by the Receiver's petition because (1) the same issues had already been decided adversely to the Receiver by a previous order which was then on appeal; (2) in a Chapter XI proceeding the Bankruptcy Court has only such jurisdiction as is reserved in accordance with the applicable statute, and in this case

there was no reservation of jurisdiction to decide the issues raised in the petition in either the plan of arrangement or the order of confirmation; and (3) the issues raised by the petition do not fall within any of the statutory reservations of jurisdiction. The Receiver in this case had no power or authority to initiate these proceedings. The petition and supplement thereto do not allege facts sufficient to warrant the subordination of the Bank's claim to that of all other creditors. The lower court did not exercise any discretion with respect to the amended petition and there could not, therefore, have been any abuse of discretion with respect to it.

Respectfully submitted,

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